CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Larry D. Lisenbee

SUBJECT: **MONTHLY FINANCIAL REPORT FOR MAY 2003**

DATE: July 14, 2003

Approved   Date

INFORMATION ONLY

The Monthly Financial Report (MFR) for May has been jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

OVERVIEW

As has been the case for this entire fiscal year, the City's financial picture continues to reflect the negative impacts of the local economic slump, showing no real signs of improvement from the status described at mid-year and in the MFRs provided since that time.

Additional negative information of particular note, has in fact, been received recently concerning our largest economically sensitive revenue category, General Sales Tax.

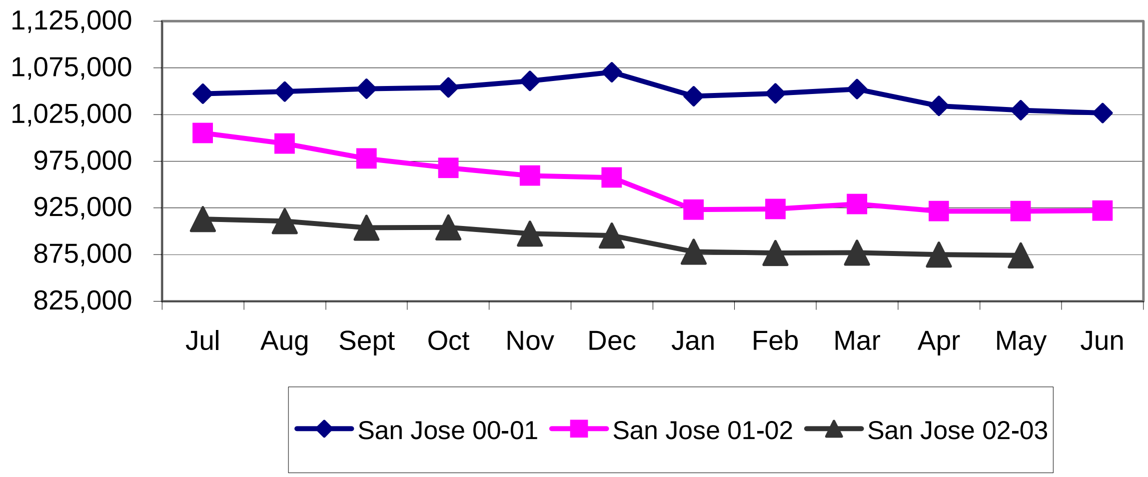
The City received Third Quarter General Sales Tax receipt information in late June. The news was once again very disappointing. For an <u>eighth</u> consecutive quarter Sales Tax receipts dropped, falling 4.8% from the prior year level. While this performance was in line with budgeted estimates (the 2003-2004 budget was built assuming a drop of 5.0% in the 2002-2003 Third Quarter), the news was still very disappointing, particularly in light of the fact that the drop was from a very poor prior year quarter that had itself been down by 24.0% from the 2000-2001 level. Sales Tax collections have now fallen to a level similar to that last experienced in 1998-1999. Unfortunately, our review of Sales Tax results from around State confirms that San Jose and Santa Clara County continue to produce the worst tax collection performance in the State.

In general, all of the City's economically sensitive revenues continue to perform below anticipated levels. For example, Planning, Fire and Public Works development services cost-recovery revenue remained below anticipated levels, which already presumed extremely low activity along with fee increases. In addition, Construction and Convenyance Tax revenue was below last year's level by 7.7%; Transient Occupancy Tax revenue declined by 10.5% (adjusted); and Commercial Solid Waste revenues also continued to perform poorly.

OVERVIEW (CONT'D.)

The most crucial indicator of economic health in our view continues to be the employment situation in the County, and unfortunately, an anemic job situation still continues to be the order of the day (see chart below). As of May, the employment total in the County was estimated at 872,600 jobs, down by 2,400 from the April 2003 adjusted number. In the June, the situation improved only slightly, with the job count increasing by 2,900 to 875,500.

San José Metropolitan Statistical Area
(Santa Clara County)
Employment: Total Jobs Comparison[1]



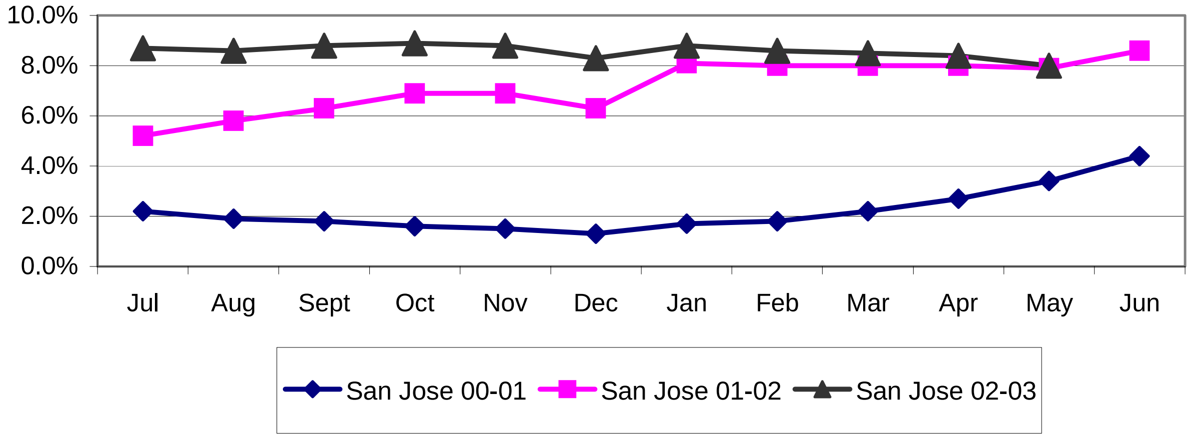
Although the forecast for the current fiscal year predicted an overall job count decline, that decline was anticipated to be only about one percent. The actual decline has significantly exceeded that level. It was also anticipated that the technology manufacturing job decline would be less than four percent. Jobs in this sector to date are actually falling at a much steeper rate (down 9.6%). This data taken together continues to indicate that a bottoming of the local recession has unfortunately not occurred, and still appears to be at least several quarters in the future.

[1] Labor Force and Industry data contained in this chart differ from previous information due to the U.S. Department of Labor's annual revision process. In addition, February was the first release of official employment estimates by industry using the new North American Industry Classification System (NAICS) instead of the Standard Industrial Classification (SIC) system.

OVERVIEW (CONT'D.)

While the May Santa Clara County unemployment rate of 8.2% was down slightly from April's revised rate of 8.4%, it still continued to run well above both the State and national rates (6.3% and 5.8%, respectively). The local unemployment rate situation actually deteriorated in June. The County rate rose to 8.5%, still well above revised State and national levels (6.7% and 6.5%).

San José Metropolitan Statistical Area
(Santa Clara County)
Unemployment Rate Comparison[2]



Adding to this dismal picture, of course is the news from Sacramento. The Governor and State Legislature continue to struggle, unsuccessfully to this point, to agree on a strategy to balance a staggering $38.0 billion deficit. As of this writing, for the third year in a row the State has entered a new fiscal year without an approved budget. The Governor's proposed budget released in January and revised in May, contained a mixture of proposals, some which were intended to take effect immediately, and some intended to go into effect with the new fiscal year. As we have discussed previously, the impact on the City of this proposal would have been devastating due to the loss of Vehicle License Fee backfill revenue. That proposal fortunately did not achieve much support from any of the contending parties. Various plans have surfaced since that time, although none to this point have gained the necessary support to achieve passage. The base disagreement between the two parties is consistent and to this point unbridgeable. The Republicans refuse to consider any revenue increases, and the Democrats will not support reductions deep enough to achieve a balanced budget with no tax increases. As usual, local government is caught in the middle. The proposals would impact the City in different ways, but all would result in a loss in State revenue, and a worsening of our budget situation. The impacts of current plans range from the approximately $16.5 million in General Fund losses which would

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[2] Labor Force and Industry data contained in this chart differ from previous information due to the U.S. Department of Labor's annual revision process. In addition, February was the first release of official employment estimates by industry using the new North American Industry Classification System (NAICS) instead of the Standard Industrial Classification (SIC) system. Further, longitudinal data from the California State Employment Development Department prior to January 2002 is not strictly comparable to subsequent data due to a change in methodology.

OVERVIEW (CONT'D.)

have resulted from the plan introduced on the Senate floor two weeks ago, to a potential catastrophic loss of up to half of our Sales Tax proceeds ($67.0 million) which would have resulted from a literal reading of the idea surfaced by the Governor's Finance Director two weeks ago. The impasse continues, and may for some time. Staff will of course continue to monitor events and will notify Council immediately of the impacts of any tangible progress.

In response to the deteriorating economic circumstances, a number of decisive actions have been taken during the year by the City Council and Administration that have followed the conservative fiscal model that has served the City well in the past. Downward revenue adjustments of $15.0 million to the Adopted General Fund Budget were recommended and approved in October as part of the City Manager's 2001-2002 Annual Report.[3] Three reserves (one of $10.9 million to address future deficits established through the Annual Report, the Reserve for Economic Uncertainty of $15.8 million, and the General Fund Contingency Reserve) were established and remain intact. Additionally, as reported in earlier MFRs, the Administration has maintained a hiring freeze in place since November 2001 that has accumulated over 800 vacancies, and implemented two consecutive cost/position management plans, the savings from which were utilized to offset revenue shortfalls reported in the Mid-Year Budget Review (Review).

As part of the mid-year Review, further downward adjustments to General Fund revenue estimates of $11.3 million were approved by City Council in response to the continued deterioration in fiscal conditions. In the area of development fee revenues, the City Council approved expenditure reductions or utilization of fee reserves to offset the projected revenue shortfalls in those programs. Finally, as noted earlier, departmental appropriations were decreased by approximately $7.6 million, reflecting savings departments were to achieve by year-end through their departmental cost/position management plans. These savings were used to partially offset the downward revenue adjustments.

At this point, although we don't know the final year-end results, the Budget Office continues to project the General Fund to end the year at or slightly above the revised ending fund balance level. It is likely to be a very close matter however, and a positive outcome will be dependent on the results of expenditure and revenue performance that took place during the final weeks of the fiscal year. Final results concerning the 2002-2003 fiscal year will be reported to the Council as part of the City Manager's Annual Fiscal Report, scheduled for release in September.

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[3] The downward adjustments were offset by higher than anticipated year-ending fund balance, and unanticipated revenue that will be available from the sale of surplus property.

GENERAL FUND

Revenue Collections

General Fund revenue collections through May 2003 totaled $ 552.8 million, a decrease of $7.7 million (1.4%) from the May 2002 level of $560.5 million. This overall performance reflects decreases from prior year levels in the following revenue categories: Sales Tax, Transient Occupancy Tax, Franchise Fees, Utility Tax, Use of Money and Property, and Other Revenue. Declines in those revenue categories were partially offset by increases in the following revenue categories: Property Tax; Licenses and Permits; Revenue from Local Agencies; Revenue from the State of California; Departmental Charges; as well as Transfers and Reimbursements.

The following discussion highlights General Fund activities through May:

KEY GENERAL FUND REVENUES
($000's)

Revenue	2002-2003 Estimate	YTD Actual
Property Tax	**$ 91,444**	**$ 84,504**

Year-to-date Property Tax revenues reflect collections in Secured Property Tax, Unsecured Property Tax, SB 813 Property Taxes (supplemental taxes), and Homeowner's Property Tax Relief.

Through May, Secured Property Tax revenues of $65.3 million were 7.2% higher than the prior year. In April, a news report indicated that reassessments had been processed, impacting property tax revenues. According to the Office of the County Assessor, however, those reassessments were already built into estimates and information received by the City and reported in prior MFRs. More recent information from the Assessor appears to confirm that contention. Including the upward adjustments approved in the Mid-Year Budget Review, it appears that this category will end the year within budgeted expectations.

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through May, Unsecured Property Tax receipts of $14.1 million reflected 2.2% growth over the prior year. Given the state of the local economy, this performance was actually better than anticipated.

Through May, SB 813 payments of $4.2 million tracked a better than budgeted 3.6% below last year's collection level of $3.6 million. Collections in this category, representing payments for taxes owed on recent housing re-sales, are typically a leading indicator of sales activities. The current modified budget assumes a 30.0% drop over the prior year, so this category is expected to end the year within budget. Revenue of $978,000 from Homeowner's Property Tax Relief was about flat compared to last year's performance of $988,000. This category is also expected to end the year within budgeted expectations.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Sales Tax	**$ 134,279**	**$ 96,865**

As described earlier, 2002-2003 third quarter General Sales Tax receipt results have been received and the data indicates that collections fell 4.8% from the same quarter in the prior year. The 2002-2003 second quarter collection represents activity that occurred January through March. This performance is a slight improvement over the prior quarter (down 6.2%) and the previous quarters before that (double-digit declines), and in line with current estimates used to build the 2003-2004 budget. However, the performance was still disturbing since that drop was in comparison with poor prior year quarter that had itself been down by 24.0% from the 2000-2001 level. A downward adjustment to the 2002-2003 General Sales Tax estimate of $11.4 million was approved by City Council as a part of the Annual Report, bringing that estimate in line with actual 2001-2002 collections and to reduce expectations to flat performance for the year as a result of the first quarter performance. The third quarter General Sales Tax performance was below the rate that will be necessary to achieve even that revised budget expectation. In fact, performance during the remaining two quarters would have to average 2.8% growth to achieve that budget. Because recent trends indicate that outcome to be very unlikely, the estimate for Sales Tax collections utilized in the 2003-2004 Adopted Budget was adjusted downward accordingly.

Revenue	2002-2003 Estimate	YTD Actual
Transient Occupancy Tax	**$ 6,700**	**$ 4,732**

TOT collections of $4.7 million through May were well below last year's level of $5.5 million. Adjusted for prior year accruals, receipts declined approximately 10.5%. Performance of this tax has still not rebounded significantly from the very depressed levels suffered in the months following the September 11 events. The May occupancy rate was 48.2%, below the April rate of 57.2%. In addition, reflecting the still depressed hotel market, the monthly average room rate continues to fall, dropping significantly in this period to $131.98 (May 2003) from $101.88 (May 2002). The 2002-2003 modified budget assumed drops in this category, but not to the extent that has occurred. Although the estimate for this category had been revised downward twice during the year, at the current collection rate receipts will likely fall short of the revised budgeted level by at least $900,000. We will continue to monitor this situation very closely and recommend appropriate actions as necessary.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Franchise Fees	**$ 31,754**	**$ 29,034**

Franchise Fees collections of $29.0 million were below the May 2002 collection level of $31.2 million. This level primarily reflects higher collections in Electric and City-Generated Tow Franchise Fees offset by lower collections from Gas and Commercial Solid Waste Franchise Fees. It should be noted that most of these receipts are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on collections in 2002. In April of each year, PG&E calculates the actual Franchise Fees due in that fiscal year based on prior calendar year activity. As reported to City Council on June 10, 2003, the Gas payment includes the quarterly installment to PG&E for its overpayment to the City during the year.

Commercial Solid Waste Franchise Fees of $6.8 million were approximately 14.7% below (down $1.2 million) the prior year level. Due to the 2001-2002 year-end performance of this Franchise Fee and analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report. More recent projections indicate that this revenue may fall below even the revised budget level by as much as $500,000. This poor performance, again, reflects the economic climate as well as additional waste diversion being experienced in the Food Waste Program and the Construction and Demolition Diversion Program. The Budget Office and ESD continue to analyze activity and refine year-end estimates.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Utility Tax	**$ 65,429**	**$ 56,109**

Utility Tax collections of $56.1 million through May were less than one percent below last year's level of $56.7 million. This year-to-date activity was primarily driven by lower performance in Electricity and Telephone Utility Taxes, partially offset by higher performance in Gas and Water Utility Taxes. Due to the 2001-2002 year-end performance of Utility Taxes and analysis related to the year-end collection level, a downward adjustment to the 2002-2003 revenue estimate was recommended and approved by City Council as part of the Annual Report. In addition, due to analysis completed in January, downward adjustments were approved in the Mid-Year Budget Review. The cumulative downward adjustments made as a part of the Annual Report and the Mid-Year Budget Review total $5.2 million. With these adjustments, this revenue category is currently expected to meet budgeted estimates.

Revenue	2002-2003 Estimate	YTD Actual
Licenses and Permits	**$ 60,706**	**$ 55,974**

Licenses and Permits revenue of $56.0 million through May was 3.8% above ($2.0 million) the prior year level of $53.0 million. Cardroom Business Tax collections ($6.3 million) were 13.0% (down $943,000) below the prior year level of $7.2 million. Though collections were down 13.0%, this revenue is actually demonstrating improved performance compared to the beginning of the fiscal year; the rate of decline has eased somewhat each month since August. For example, April experienced a drop of 14.5%; and March, February, November, and October experienced drops of 16.0%, 17.3%, 25.4%, and 31.0%, respectively. The November year-to-date performance was primarily the result of revenue losses in the first four months of the year from Bay 101 related to its bankruptcy filing. July's revenue was down approximately 60.0% from the prior year. The current budget allows for an overall drop of approximately 13.0%. This revenue category is still expected to meet budgeted expectations. Staff will continue to monitor this revenue source closely.

Disposal Facility Tax revenue of $13.7 million although above prior year levels, is actually running below originally budgeted expectations. As a result of prior year-end performance analysis of the Disposal Facility Tax, a downward adjustment to the current year estimate was recommended and approved by City Council in October. Throughout the year, this revenue's

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Licenses and Permits (Cont'd.)	**$ 60,706**	**$ 51,181**

performance has been driven in large part by market reactions to the removal of the Alternate Daily Cover exemption. Apparently, a portion of the yard trimmings that typically went to City landfills in the past has been transported to other locations (e.g., biomass facilities for energy production). This market reaction seems to be leveling off, stabilizing in the past three months or so. As a result of the slight improvement February through May coupled with the Annual Report downward adjustment, this revenue source is expected at minimum to meet the budgeted level by year-end.

Fire Permit revenues of $5.0 million continued to track below anticipated levels through May. Current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Collections through May reflect activity levels that are below that anticipated in the budget. In the Mid-Year Budget Review, revenues and commensurate expenditures were reduced by $500,000, lowering expectations. Despite that action, at this point, revenue from this source is still estimated to end the year below the revised expectations by at least $450,000.

Building Permit revenues of $14.4 million tracked above last year's level and at revised anticipated levels. May's activity levels continued a trend of higher collections in place since February, the highest month of activity for the year. Activity still continues to consist almost entirely of high-density, multi-family housing projects. Commercial activity, however, remains slow and industrial activity is almost non-existent, reflecting a consistently depressed activity level. Thus, high residential and remodel activity continues to be the only area supporting this development fee program. Fee increases of approximately 12.0% were approved in the current budget along with a few new fees. In the Mid-Year Budget Review, revenues and commensurate expenditures (fee reserve) were reduced by $500,000, lowering expectations. Though it is hoped that year-to-date activity through May is indicative of activity for the remainder of the year, a gap of approximately $150,000 is still currently estimated by year-end. As with all revenue categories, these fees will continue to be closely monitored and adjustments to the revenue estimate, if appropriate, recommended as more information becomes available.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Use of Money and Property	**$ 11,208**	**$ 10,222**

Use of Money and Property revenues of $10.2 million were well below the prior year level of $16.2 million but at revised current year expectations, reflecting lower cash balances in many funds, including the General Fund, which have resulted in lower interest earnings for all funds. The Adopted Budget for General Fund interest earnings was built anticipating a significant drop in the average cash balance for the year, but these declines along with lower interest earnings rates through December exceeded expectations. Consequently, a downward adjustment of $1.9 million was approved through the Mid-Year Budget Review. As a result, this revenue category is currently anticipated to meet the budgeted level.

Revenue	2002-2003 Estimate	YTD Actual
Revenue from Local Agencies	**$ 43,472**	**$ 36,327**

Revenue from Local Agencies of $36.3 million was 1.9% above ($669,000) the prior year level of $35.7 million. This variance was primarily driven by earlier receipt of several grants offset by lower than anticipated reimbursements from the Redevelopment Agency ($1.5 million). Given the current information related to the Agency and its budget, reimbursement for services from the Agency could fall short of budget by as much as $1.5 million.

Revenue	2002-2003 Estimate	YTD Actual
Revenue from the State of California	**$ 58,902**	**$ 51,202**

Revenue from the State of California totaled $51.2 million, representing a 4.1% increase from prior year collection level of $49.2 million. The majority of this increase, however, reflects the deletion of a $3.0 million accrual from last year for open space activities from Proposition 12; the payment for the grant was finally received in May.

This category also includes Motor Vehicle In-Lieu Fee (MVLF) payments of $45.0 million, reflecting year-to-date growth of 8.0% ($3.3 million). Though new car sales seem to be softening, as discussed earlier in the Sales Tax portion of this memo, at this point, barring intervention by the State, the MVLF source is still anticipated at least to reach the budgeted level of $52.5 million.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Departmental Charges		
-Public Works	**$ 6,100**	**$ 4,876**

Public Works revenue of $4.9 million was 4.8% below last year's level, and 15.5% below the anticipated level despite the fact that several new fees were implemented. Similar to the other development fee categories, current year revenue estimates were built assuming a continuation of the activity levels of last year, with the higher fee levels approved by City Council. Activity levels have not reached those anticipated levels. As a result, a Mid-Year adjustment of $256,000 was approved. April performance reflects continued weak activity in virtually all fee categories, with the poorest performances from Grading Permits, Non-Residential Engineering, and Utility Excavations. Despite the Mid-Year adjustment, a gap of at least $500,000 is still currently estimated by year-end.

Revenue	2002-2003 Estimate	YTD Actual
-Transportation	**$ 882**	**$ 604**

Transportation Revenues of $604,000 tracked 33.3% below the prior year level of $906,000. The weak performance has been driven primarily by lower than anticipated revenues from Residential Permit Parking, Signal Review, and Sidewalk Repair Administrative Charges. Current projections indicate that this revenue source will end the year below budgeted levels by as much as $200,000.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Departmental Charges (Cont'd.)		
-Planning	**$ 3,924**	**$ 3,341**

Planning revenues of $3.3 million tracked 1.7% above last year's level of $3.3 million, but below anticipated levels. As with the other development-related revenue sources, current year revenue estimates were built assuming a continuation of the activity levels of last year along with higher fee levels approved by City Council. Revenues received in all categories are either at or above anticipated levels, except for the Non-Residential area of PD prezonings/rezonings, environmental clearance reports, site developments, and conditional use permits. A shortfall of $200,000 is currently projected by year-end.

Revenue	2002-2003 Estimate	YTD Actual
-Parks, Recreation, & Neighborhood Services	**$ 7,513**	**$ 6,906**

Parks, Recreation, and Neighborhood Services (PRNS) revenue of $6.9 million tracked 5.8% below last year's level of $7.3 million. Generally, all PRNS revenues are tracking slightly below budgeted levels. Current estimates indicate that PRNS revenues will end the year at least $250,000 below budgeted levels.

Revenue	2002-2003 Estimate	YTD Actual
Other Revenue	**$ 11,721**	**$ 10,789**

Other Revenue collections of $10.8 million were significantly below the prior year level of $21.0 million. On an overall basis, however, most revenues in this category are tracking within budgeted levels. The decline from the prior year primarily reflects last year's booking of one-time settlement revenue from the County in the amount of $5.5 million; budgetarily moving the Solid Waste Enforcement Fee to the Departmental Charges; the loss of SB 90 reimbursement revenue; last year's booking of one-time revenue from Calpine/Bechtel for a parks reserve, now reflected in the Capital Budget; and the absence of the Packard Smart Start grant (now booked in Revenue from Local Agencies).

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
($000's) (Cont'd.)

Revenue	2002-2003 Estimate	YTD Actual
Transfers and Reimbursements	**$ 83,135**	**$ 84,999**

Transfers and Reimbursement collections of $85.0 million were 25.4% above ($17.2 million) the prior year level of $67.8 million. This performance reflects higher collections of operating and capital/special fund overhead, as well as one-time transfers, including $14.0 million from the Low/Moderate Income Housing Fund for the sale of surplus property, $1.8 million from the Vehicle Maintenance and Operation Fund as a result of the vehicle audit, and higher reimbursement from the Airport for Fire and Police services. These one-time transfers were partially offset by lower transfers from the Construction Excise Tax, the absence of a one-time transfer from the Healthy Neighborhoods Venture Fund for general liability, and the absence of a one-time transfer from the Sewer Service and Use Charge Fund from interest earnings.

EXPENDITURES

Through May, General Fund expenditures of $620.8 million were 3.0% ($18.2 million) above the prior year level of $602.6 million. Encumbrances of $36.0 million were 16.3% below (down $7.0 million) the prior year level of $43.0 million. Expenditures and encumbrances ($656.8 million) through May constitute 84.8% of the total 2002-2003 revised budgeted use of funds ($774.3 million, excluding reserves).

With the exception of the Fire Department, individual and cumulative departmental and non-departmental expenditures appeared to be within or below approved budgeted levels through May.

The following discussion highlights General Fund expenditure issues:

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
($000's)

Department	2002-2003 Budget	YTD Actual
Police	**$ 216,589**	**$ 192,522**

On an overall basis, Police Department expenditures tracked at lower than estimated levels. Although the Department's personal services expenditures tracked at higher than expected levels (91.2% compared to 90.4% par level), this higher level of expenditure is attributed to the continued overtime usage for Airport security activities, as well as to a lower than projected attrition rate. Through May, it appears that a higher Academy retention rate and a lower retirement rate are expected to result in a higher than budgeted year-end personal services expenditure. .

As part of the continuation of the Sworn Recruitment and Training Program, the 33 Officers that were part of the July 2002 Academy completed in-field training in May 2003 and have been deployed to patrol duties. In addition, a total of 35 recruits currently in the January 2003 Academy are expected to be street ready in October 2003.

During the Mid-Year Budget process, the Airport provided additional funding to offset General Fund expenditures for Airport-security related activities through February. The Airport will provide overtime reimbursement for the remainder of the year in June once the exact amount is known. The Airport and Police Departments as well as the Budget Office continue to work on projecting the year-end overtime amount.

Overall, overtime expenditures through May were slightly below expected levels at $9.4 million or 89.2% of the budgeted level (compared to the estimated level of 90.4%). Overtime usage for non-Airport security-related activities however tracked at much lower than expected levels. In February, the Police Chief issued a special memorandum covering guidelines for overtime usage. All overtime activities, with the exception of MOU overtime requirements would require pre-approval of overtime requests by the Office of the Chief of Police.

The compensatory time balance at the end of May is 220,573 hours for sworn personnel, representing an increase of 9,849 hours (4.7%) from the June 2002 balance of 210,724 hours. This level also represents an increase of 5,496 hours (2.6%) from the May 2002 balance of 215,077 hours.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES
($000's)

Department	2002-2003 Budget	YTD Actual
Fire	**$ 109,201**	**$ 99,661**

Through May, expenditures for the Fire Department continued to track above budgeted levels. The Department's personal services expenditures remained the issue, tracking at much higher than budgeted levels, reflecting the combined impact of a higher than needed non-paramedic firefighter count, and a change in the method of paramedic staffing deployment.

The Department currently has a total of 208 filled paramedics (122 front-line and 86 support), the highest level in the Department's history. The front-line total is, however, still 25 short of the 147 that are necessary to staff all apparatus fully. Last year, to address the paramedic staffing imbalance, and stay within its budget, the Department filled front-line paramedic duty requirements by deploying both front-line and support paramedic personnel. This process has been suspended since July to conduct an assessment of the impact of "dual role" practice. This suspension has, however, resulted in the Department's personal services tracking significantly higher than expected.

In March, the accelerated accreditation process (initiated in November 2002) for 13 Firefighter Paramedics resulted in an increase in the number of front-line Paramedics. In addition, the 16 Firefighters currently enrolled in the Northern California Training Institute's Paramedic School have completed classroom training and have been able to fulfill duty slots during off- training hours. These 16 Firefighters are expected to be accredited in December, 2003, thus further increasing the number of front-line Paramedics to a projected level of 136 (factoring in projected retirements and promotions). The City Manager's Office will continue to work with the Department and the union on a long-term stategy to fill front-line paramedic staffing needs.

To reduce overtime usage and fill front-line vacancies, the Department redeployed personnel from four brush patrol and one water tender companies (coinciding with the end of the Wildland Fire Season) and also redeployed personnel on administrative duties. In early March, the Department issued a Special Bulletin that included expenditure control measures. Except for fulfillment of minimum staffing needs, since that time overtime usage has requireed prior review and approval by the Fire Chief's Office.

Incorporating the proposed deferral of the purchase of a fire truck for training and including additional reimbursements for mutual aid of approximately $80,000, the year-end shortfall is currently projected at $1.5 million. Current estimates indicate that the Department's level of non-personal/equipment expenditures will end the year within budgeted levels.

GENERAL FUND (CONT'D.)

OVERTIME EXPENDITURES

On an overall basis, overtime expenditures tracked below or at anticipated levels, primarily driven by the controls on the use of overtime implemented in response to City Council direction at the beginning of February. With the exception of the Fire Department as well as Parks, Recreation, and Neighborhood Services Department, preliminary information provided by the major departments indicates the following:

- As directed, overtime usage is being authorized by department directors for emergencies and genuine, unavoidable expenses only.
- Genuine unavoidable expenses included such things as aged compensatory time paid, and required coverage during non-traditional business hours and/or holidays.

Based on data through May, it appears that departments were exercising greater control of overtime authorization and containing overtime costs. The Administration will continue to monitor and report on overtime containment and report as directed by City Council in coming Monthly Financial Reports as well as the 2002-2003 Annual Report.

CONTINGENCY RESERVE

Through May, the General Fund Contingency Reserve was down by $804,000 from the 2002-2003 Adopted Budget level of $24,549,175 (to $23,745,175). This reflects the following revisions to the Contingency Reserve that were approved through May:

- A decrease of $27,500 to provide matching funds for an Office of Criminal Justice Planning "Domestic Violence" grant.
- A decrease of $35,000 to provide for studies required to amend the General Plan related to the Almaden Youth Association Agreement.
- A decrease of $101,500 to provide the City's match for the Local Law Enforcement Block Grant.
- A decrease of $140,000 to provide additional funds related to the Campaign Review and Ethics Board.
- A decrease of $500,000 to provide additional funds related to the Housing Assistance Program for Council Appointed Officials and Senior Staff.

OTHER FUNDS

Construction and Conveyance Tax Funds

Construction and Conveyance Tax revenues through May exceeded estimated collection levels due to stronger than anticipated receipts, particularly in the first half of the year. In recent months, however, collections have begun to decline compared to prior year collections. The activity in the real estate market is reflective of this trend. For instance, the number of single-family homes sold in May dropped almost 16% from May 2002 and those homes took longer to sell with the average days-on-market increasing from 31 days to 56 days. The drop-off in the number of sales of condominiums and town homes was more pronounced with a 31% decline in May 2003 when compared to May 2002.

Through May, $19.6 million in actual tax revenues was received (122.5% of the 2002-2003 estimate of $16 million). This collection level was 7.7% lower than revenues received through May 2002. While year-to-date collections were fairly close to the prior year, receipts for the month of May were 27% below the May 2002 collection level. This marked the fifth consecutive month in which collections declined from the prior year. It is anticipated this negative trend will continue as a reflection of the prolonged economic downturn. While the declines in recent months were more in line with a budgeted estimate that allowed for a 39% decrease from the 2001-2002 collection level, the strength of collections in the first half of the year has resulted in year-to-date receipts exceeding the budgeted level.

Other Construction-Related Revenues

As reported in prior months, construction-related revenues have recently provided some rare good news. Construction-related tax revenues have been depressed for over a year and a half. However, since February, receipts have been remarkably strong and current year collections have exceeded the prior year’s significantly reduced collection patterns. In fact, due largely to residential and commercial activity, current year receipts look likely to make 2002-2003 the strongest year since the boom year of 2000-2001.

May’s revenues in this category, while somewhat lower than April’s collections, remained strong compared to performance in the first half of the year. Reasonably robust commercial activity drove May’s receipts, as a result of continued construction at two regional shopping centers, *Santana Row* and *Oakridge Mall*. In contrast, however, residential activity dropped somewhat, and industrial activity was nonexistent. For the fifth time this fiscal year, no new industrial construction permits were issued. Despite a near-halt in industrial development, the year-to-date total of the seven revenue sources monitored for this report is $25.6 million, an increase of 17% from the $21.9 million collected through the same period last year. On an overall basis, this performance is better than modified budget estimates that allow for a 21% drop from the prior year.

OTHER FUNDS (Cont'd.)

Other Construction-Related Revenues (Cont'd.)

Specifically, year-to-date revenues from the two most important sources in this category – Building and Structure Construction Taxes and Construction Excise Taxes – now exceed year-end estimates for current year collections by more than 10%. Construction Excise Tax receipts through May totaled $14.6 million (120% of the current 2002-2003 estimate of $12.1 million). Current year-to-date performance is now tracking 17% higher than last year's $12.5 million received over the same period. Given this unexpectedly strong performance, Construction Excise Tax receipts estimates were raised by a conservative $1,200,000 during the Spring Clean-Up. Building and Structure Tax receipts through May yielded $9.2 million (133% of the current 2002-2003 estimate of $6,924,000). This represents an increase of 10% from the revenues collected through the same period last year ($8.3 million).

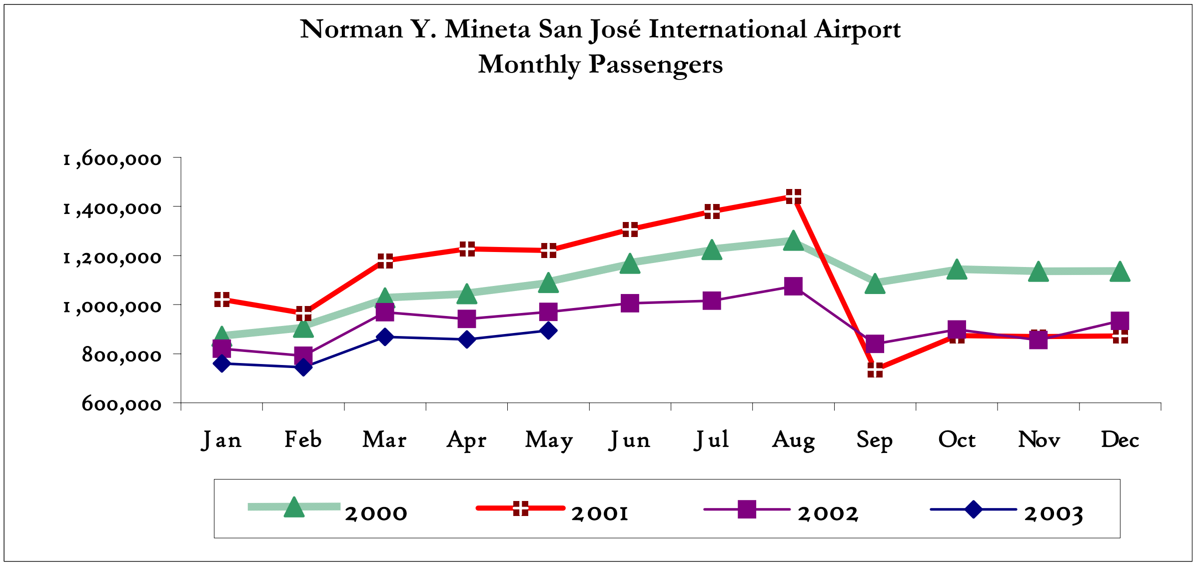
This pattern of strong results is also visible in other construction-related revenues. All of the smaller revenue categories outperformed prior year data, with one exception: Municipal Water Service Connection Fees tracked below prior year collection patterns. Sanitary Sewer Fee receipts through May totaled $1.0 million (148% of the current 2002-2003 estimate of $703,000), a level equal to 120% of last year's $867,000 collected over the same period. Fee receipts through May for the Storm Drain Fees totaled $393,000 (112% of the current 2002-2003 estimate of $351,000), which corresponds to 106% of the $373,000 received over the same period last year. Residential Construction Tax receipts through May reached $261,000 (327% of the modified estimate of $80,000), which corresponds to 171% of last year's receipts of $153,000 through May. Major Facilities Fees collections through May totaled $114,000, (229% of the revised 2002-2003 estimate of $50,000). In contrast, Service Connection Fee receipts through May totaled $58,946 (18% of the current 2002-2003 estimate of $320,000), 43% below collections through May 2002 ($102,903). Because Service Connection Fee revenues recover actual costs to install new services, this revenue decline is coupled with a decline in costs, as well. Staff will continue to monitor these revenues closely.

Airport Funds

On a fiscal year-to-date basis, the Norman Y. Mineta San Jose International Airport (SJC) enplaned and deplaned just over 9.7 million passengers, a reduction of 8.6% from the figures reported through May for fiscal year 2001-2002. Passenger activity continues to be adversely impacted by such factors as the downturn in the high-tech economy and the industry-wide effects of the September 11th terrorist attacks. In May 2003, the Airport served 894,769 passengers, a 7.7% decrease from May 2002 passenger levels.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)



Terminal C passenger activity for May increased 3.7% from the May 2002 level; however, activity for the current fiscal year still lags the previous fiscal year by 4.8%. Air carriers reporting reduced fiscal year passenger totals are United (15.3%), Continental (9.5%), Alaska (4.1%), Northwest (3.5%), and Delta (20.6%). Terminal C carriers experiencing fiscal year passenger growth include America West (1%), Mexicana (9.5%), Horizon (38.4%), Frontier (869.9%), Mesa (84.9%), and Skywest (62.1%). The advent of operations by American Trans Air has resulted in 96,418 additional passengers flying out of Terminal C this fiscal year. May 2003 activity in Terminal A is 13% lower than the figure reported in May 2002 and, overall, is down 10.9% in fiscal year comparisons. Despite the growth of American Eagle regional service, American's current fiscal year passenger levels are 22.7% lower than the previous fiscal year. Southwest's passenger activity is 1.7% higher than the previous fiscal year. Good news was announced recently. On June 17, American Airlines restored its Tuesday flight to Narita, Japan. The flight had been dropped May 1, 2003.

Fiscal year-to-date mail, freight and cargo totaled 253 million pounds, which represents a 10.6% decrease from 2001-2002. The decrease is largely attributable to the termination of operations of Emery Worldwide Airlines and Kitty Hawk Air Cargo, although all cargo carriers showed reduced levels of activity. Fiscal year-to-date domestic cargo is down by 9.5%.

May 2003 taxicab operations decreased by 7.9% from those in May 2002. Fiscal year to date totals are 6.9% lower than those recorded in 2001-2002. Fiscal year to date Passenger Facility Charge (PFC) revenues through March 2003 are 5.0% lower than the previous fiscal year.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)

Year-to-date operating revenues of $84.38 in the Airport Revenue Fund are 99.0% of budgeted levels principally due to lower than anticipated revenues from parking and roadway and general & non-aviation programs. Parking revenues were down because of restrictions not allowing meeters and greeters beyond security checkpoints. General and non-aviation revenues are lower than anticipated due to the reversal of an accounting adjustment made in 2001-2002. Landing fees, terminal rentals, airfield, and petroleum program are all tracking above the prorated budget while terminal concessions and miscellaneous rents, and transfer from Airport Improvement Program grant money is tracking at 100% of projections.

Through May, the Airport continues to manage costs according to internal savings targets, which were identified as part of an overall effort to reduce the expenditures. Total reductions of $3.54 million have been identified for the Airport Maintenance and Operation Fund, or $0.3 million in personal services and $3.24 million in non-personal/equipment. As of this writing the Airport expects to surpass its savings target by $1.9 million, saving a total of $5.4 million (or approximately 8.0%) by fiscal year-end.

Expenditures in the Airport Maintenance and Operating Fund (Fund 523) are tracking below budgeted levels in both the personal and non-personal service categories. Measuring against the Airport's budget less savings targets, personal services expenditures totaled 86.2% of budget (or $22.7 million) compared to the prorated benchmark of 90.4%. By the end of 2002-2003, the Airport anticipates expending $25.3 million or 3.7% below the Department's personal services budget. This amounts to approximately $1.0 million in savings, exceeding the Airport's target of $0.3 million.

The Airport has made a deliberate effort to reduce personal service expenditures through the maintenance of departmental vacancies, and tight control and limited use of overtime. Through May, the Airport carried a total of 67 vacancies, of which 38 are funded. Of the 38 positions, 16 new positions are funded through the Airport Capital Budget to implement the Master Plan.

Overtime expenditures to date total $[illegible]955 (60% of [illegible]get), as compared to $374,855 YTD in 2001-2002. Overtime at the Airport is used to provide critical holiday coverage, after hours support, maintain mandated staffing levels and provide emergency response. Summary of Airport Overtime use for May 2003 - for the most part overtime (97 hours) was directly related to emergency repairs and critical capital improvement projects (One-way Loop roadway markings). Of the 137 hours of paid and comp overtime reported, 31 hours were related to minimum level staffing of Manager On Duty Program and weekend standby coverage provided for response to emergencies associated with the HVAC and electrical systems. Paid overtime for Airport employees for May 2003 totaled $3,852 as compared to $14,266 paid in May 2002.

OTHER FUNDS (Cont'd.)

Airport Funds (Cont'd.)

Non-personal expenditures through May total $25.0 million, or 66.12% of the budget after reductions. Current encumbrances amount to $8.4 million, which brings total non-personal commitments to 88.4% of the modified budget for May. This reflects significant savings year-to-date, primarily in contractual services, printing/advertising, and supplies. By the end of 2002-2003 the Airport will record an estimated $4.4 million in non-personal savings, exceeding its own internal savings target of $3.24 million.

Year-to-date revenues from the Airport Customer Facilities and Transportation Fee Fund (Fund 519) of totals $3.5 million are 6.0% below anticipated budget levels due to reduced activity and slightly below the prior year levels by approximately 3.0%. Current year expenditures, when adjusted to include $140,533 of expenses incurred in May 2003 but not posted until June 2003, are 9.0% less than expe[illegible] and 2.0% less than fiscal year 2001-02. Expenditures tracked lower than anticipated due to vacancy savings, as well as lower than anticipated bus insurance, fuel, land lease, and bus operator and maintenance/lease costs. April's average daily shuttle bus ridership was only 72.0% of May 2002 and 5.3% less than the prior month.

Transient Occupancy Tax Fund

TOT Fund collections of $7.2 million through May were approximately 10.5% below last year's level, adjusting for accruals. As was described above for General Fund Transient Occupancy Tax collections, performance of this tax has simply not rebounded from the depressed levels suffered in the months following the immediate aftermath of the September 11 events, and collections have remained sluggish throughout the current fiscal year. The May occupancy rate was 48.2%, below the April rate of 57.2%. In addition, reflecting the depressed hotel market, the monthly average room rate fell dramatically, dropping to $131.98 (May 2003) from $101.88 (May 2002). The 2002-2003 modified budget assumes a drop in this category of approximately 1.8% over the 2001-2002 collection level. Due to the lower than expected 2001-2002 collection level of $1.05 million, in October, reductions of $262,740 for the Convention and Visitor Bureau and the Arts Groups allocation were approved by City Council, as was a reduction of $525,420 to the Conventions, Arts, and Entertainment Department (CAE). Additional downward adjustments were approved as a part of the Mid-Year Budget Review. The adjustments resulted in additional decreases to revenue available for allocation to the three TOT Fund recipients. The impact reduced allocations by $1.3 million for CAE, and $650,000 for the Convention and Visitor Bureau and $326,000 for the Arts Groups. Since May collections were worse than anticipated, our latest year-end projections now indicate we are likely to fall below even the revised lower estimate by as much as $1.2 million. The recipient groups have been notified that they will likely have to absorb yet another reduction in their allocation when the final total is known next fall.

OTHER FUNDS (Cont'd.)

Convention and Cultural Affairs Fund

On an overall basis, both revenues and expenditures in the Convention and Cultural Affairs Fund were lower than expected through May. Convention Center occupancy continues to run near 75.0% year-to-date. Reflecting that occupancy level, downward Mid-Year adjustments of $3.3 million were approved as a part of the Mid-Year Budget Review. Even with those adjustments, however, the fund will likely experience a further year-end shortfall of at least $400,000, primarily driven by lower concessionary income (e.g., food and beverage).

Integrated Waste Management Fund

Overall, through May, revenues tracked below estimated levels and expenditures tracked above anticipated levels. This performance is driven by Recycle Plus rate increases that will impact the fund in the latter part of the fiscal year; lower than expected Yard Trimmings cart subscriptions (15.0% versus an anticipated 30.0% level); and lower Commercial AB 939 fees impacted by the economy and increased diversion. Current estimates project revenues to fall short of budget by at least $1.0 million. Higher than anticipated expenditure levels were primarily due to higher Multiple Family Dwelling contract expenditures as a result of higher than expected recycling cart subscriptions; and higher workers' compensation claims. In addition, Single Family Dwelling projections related to the Recycle Plus contract will impact this fund, requiring a year-end clean-up for this and the other expenditure-related previously mentioned. By year-end, current projections indicated that this fund would have ended the year close to $1.0 million below anticipated levels. As a result, appropriate budget adjustment actions to remedy this problem were recommended and approved by Council as part of the final year-end clean-up.

CONCLUSION

Economic indicators and City revenue collections continue to confirm the fact that we suffer from the impacts of a severe and continuing economic downturn from which we should not expect significant relief in the immediate future.

Although the severity of the economic situation has been greater and longer lasting than anticipated, the fact that we are experiencing a downturn did not come as a surprise. Based on our early predictions about a coming problem, the Administration and the City Council have continuously and decisively taken actions over the last two years to prepare for this situation. Surplus prior year funds were diverted from the previously scheduled establishment of new projects, and used instead to fund reserves to address the downturn. These reserves remain untapped. Approximately 19 months ago, the Administration implemented hiring and expenditure controls that continue today, and began early this year to develop plans to close a huge gap in the 2003-2004 budget. Per City Council direction

CONCLUSION (CONT'D.)

in approving the recommendations included in the Mayor's Budget Strategy Memorandum, in January additional stringent cost containment measures were put in place (e.g., freeze on major renovations, travel, equipment expenditures, overtime, etc.) and continue to this day. Finally, in June, the City Council adopted a budget for the new fiscal year (2003-2004) which closed gaps in a number of City funds, including a $81 million General Fund shortfall. Actions necessary to close these gaps involved significant service reductions and the loss of close to 300 City positions.

The combined impact of these various measures have allowed us to weather the economic downturn to date, but we clearly will have additional work to do to bring our expenditures into alignment with long-term projected revenue streams, particularly in light of the still unknown potential impact of the State budget process.

We remain very confident however, that our track record of prudent financial planning will continue to serve us well, and we will respond to this crisis appropriately. As always, staff will continue to closely monitor our current year financial status and report regularly to the Council on any significant developments through this reporting process.

LARRY D. LISENBEE
Budget Director